

Pensions CIV Sectoral Joint Committee

Item no: 5

Stewardship and Voting

Report by: Hugh Grover **Job title:** Chief Executive, London LGPS CIV Ltd

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Contact Officer: Hugh Grover

Telephone: 020 7934 9942 **Email:** hugh.grover@londoncouncils.gov.uk

Summary This report provides the committee with the latest thinking and detail about the possible voting policies that the CIV may employ at launch.

Recommendations The committee is recommended to:

- i. Note the contents of this report;
- ii. Provide feedback on the possible options for voting as laid out in the report.

Stewardship and Voting

Introduction

1. The question of how share voting will be handled on the CIV was raised at the Pensions Sectoral Joint Committee meeting of 17th December 2014. Due to the stage that the CIV project was at during December, the options for voting were not particularly transparent.
2. As the launch of the vehicle approaches and discussions have been held with boroughs and managers as to the mechanisms available through the structure, the options have become clearer, but greater understanding on the variety of Borough approaches and requirements is needed.
3. This report discusses some of the issues surrounding voting and suggests some of the options that the CIV could adopt on behalf of its investors.

Discussion

4. The judicious use of shareholders' voting rights is a key part of the role of responsible investors as stewards of capital. Research suggests that in most cases Pension Funds have delegated responsibility to fund managers to vote shares on their behalf, although it is recognised that a minority of funds also employ voting agencies to undertake this function on their behalf. Most fund managers, both active and passive, now have governance departments which work closely with companies, and take their voting responsibilities and corporate governance seriously. There is a recognition that good corporate governance in companies should over the longer term deliver more sustainable returns for its investors. Fund managers should also strive to ensure that management do not act in ways which are detrimental to shareholders' interests or contravene the underlying investors' principles.
5. Furthermore, there are regulatory requirements for the LGPS. Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 Regulation 12 requires Administering Authorities to publish their voting policy where they have one in the Statement of Investment Principles (SIP):

(g) the exercise of the rights (including voting rights) attaching to investments, if the authority has any such policy;
6. In addition Regulation 12 (3) requires Pension Funds to include a statement on the extent to which the investment fund complies with guidance given by the Secretary of State and in the case of the LGPS, this is with reference to the CIPFA Guidance on the Myners Principles which includes the extent to which they meet requirements for Responsible Ownership:

Responsible Ownership

Administering Authorities should:

- Adopt or ensure their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents,
- Include a statement of their policy on responsible ownership in the Statement of Investment Principles; and
- Report periodically to scheme members on the discharge of such responsibilities.

7. Whilst the CIV is not required to have a Statement of Investment Principles, it is recognised that the underlying Pension Funds are required to do so and to publish voting policies. It is therefore appropriate that the CIV considers what options are open to the underlying Pension Funds as they invest through the CIV and what might be appropriate for the CIV to undertake.
8. Where sub-funds are investing in pooled funds such as index trackers, there is limited scope to differentiate voting policy for Borough Pension Funds, unless it is a dedicated CIV pooled fund. Therefore, whilst funds might want to apply pressure to their index managers to vote in a certain way, the reality is that shares tend to be voted on bloc and investment funds are therefore reliant on the investment manager themselves have a proactive approach to good corporate governance. For segregated funds, there is clearly scope to direct voting with managers, although again this may not be as easy where the managers themselves have outsourced this function to an external voting agency such as ISS.
9. As noted above, research suggests that currently many boroughs delegate voting responsibility to the fund managers, and clearly this would be one **option** for the CIV to consider.
10. Of the London Pension Funds who have signed up to the CIV, 19 of them are members of the Local Authority Pension Fund Forum (LAPFF) <http://www.lapfforum.org/> which represents the interests of local authority pension funds and collective engagement with companies, effectively acting as a local authority pressure group and is increasingly acting with other large shareholders to apply pressure on companies to improve not only corporate governance but also adopt a more responsible approach to the way they conduct business.
11. As an organisation, LAPFF represents the interests of approximately £160bn worth of local authority assets giving the group leverage with company managements. LAPFF are advised by PIRC and regularly send recommendations to funds on company voting, which many will then request/direct their managers to vote in accordance with the recommendations provided by LAPFF.
12. A second **option** to consider would be whether the CIV should also become a member of LAPFF (assuming it is able to do so) representing the interests of all Pension Funds' assets within the CIV and where feasible to vote shares in accordance with LAPFF recommendations or to seek explanations from the underlying investment managers why they have not followed their recommendations. Voting could also be incorporated as part

of the reporting package to Pension Funds on a quarterly basis. Taking up membership of the LAPFF could provide the CIV with a relatively low cost effective mechanism to demonstrate its commitment to shareholder engagement and voting.

13. Another **option** would be for the CIV to consider whether to engage the services of an external voting agency direct such as PIRC or Manifest. This would enable, where feasible, shares to be voted directly on behalf of assets held by the CIV. The costs of such a service would need to be established, but would undoubtedly be higher than the cost of membership of LAPFF (which already takes advice from PIRC). Voting services carry with them a cost that the boroughs will be required to bear through the CIV.
14. This cost will be subject to the volume of voting and the pricing structure agreed with the voting agency. However, this may enable a greater level of direct voting than is possible with just using LAPFF as they would vote on behalf of the underlying shareholders according to a set of guidelines which could be drafted by shareholders of the CIV. The advantage of using a voting agency is that the investors will know exactly how their votes will be cast on all ESG matters. However, investment managers argue that removing the votes from “their” shares carries with it a real cost, as the fund managers effectively lose leverage over, and perhaps a degree of access to, management.
15. Most of the existing investment managers used by London authorities are signatories of the UK’s Stewardship Code and many are also signatories of the UNPRI (United Nations Principles for Responsible Investment). As responsible investors the CIV could also seek to ensure that the managers who are appointed to the CIV are signatories of one of the Stewardship Codes. Whilst larger investment managers with a wide spread of asset classes under management are almost certainly likely to be signatories to one or both Codes, smaller or more alternative type managers are less likely to be so.
16. Therefore to restrict entry to the CIV for managers unless they are signatories could have the effect of severely limiting the CIV’s access to a wider range of investment managers and possibly impact on performance over the longer term. Indeed some would argue, (particularly hedge funds and other alternative asset managers) that as they are not necessarily long term shareholders of underlying companies, they do not need to be signatories to such codes.
17. In the same way that the boroughs vote at the moment, there will be a difference between voting on pooled funds and segregated accounts. If a particular sub-fund is invested in pooled funds, the voting will continue to be managed by the fund manager, possibly with guidance from the borough, or a request that an investment manager refer to the boroughs voting principles.
18. In a segregated account, voting decisions will remain with those boroughs invested into the sub-fund. The question of splitting the share voting on these segregated assets has been raised with investment managers, and although they have demonstrated reservations about vote splitting, they have indicated that it is a method that can be adopted in certain circumstances. Again this is very much subject to the views of those boroughs invested in the sub-fund, and the decision taken by the CIV towards segregated account voting, but in principle split voting would seem to go against the principles of collaboration that underlie the CIV.

19. The boroughs will need to decide whether they wish to make voting decisions on a sub-fund by sub-fund basis or whether the CIV adopts policies that will be utilised across the sub-funds, whether by an external provider (such as PIRC or ISS) or by the managers under instruction by the CIV.

Recommendations

20. The committee is recommended to:

- i. Note the contents of this report;
- ii. Provide feedback on the following possible options for voting:
 - a) Draw up and adopt a set of 'CIV' voting principles and leave voting in the hands of the fund managers
 - b) Hire a voting consultant to handle the voting on behalf of the CIV
 - c) Adopt the voting principles of the LAPFF and consider membership for the CIV

Financial implications

21. There are no financial implications for London Councils.

Legal implications

22. There are no legal implications for London Councils.

Equalities implications

23. There are no equalities implications for London Councils.